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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

September 18, 1996

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W. Room 222
Washington, D.C. 20554

**EX PARTE: Federal-State Joint Board on Universal Service
CC Docket No. 96-45**

Dear Mr. Caton:

GTE has proposed an auction mechanism for determining universal service support in the captioned docket. In response to questions raised by Commission Staff, GTE has prepared the attached memorandum demonstrating that the Commission has the authority under the Telecommunications Act of 1996 to establish a competitive bidding design for determining universal service assistance.

As detailed in the memorandum, the 1996 Act gave the Commission the authority to develop a universal service support mechanism as long as it is specific, predictable, and sufficient. Because GTE's auction proposal satisfies these statutory requirements and would promote the public interest, the Commission should adopt GTE's auction proposal.

Please call me if you have any questions regarding this matter.

Sincerely,

Whitney Hatch

Attachment

cc: Federal State Joint Board Commissioners and Staff
G. Keeney
W. Kennard

No. of Copies rec'd 081
List A B C D E

COMPETITIVE BIDDING FOR UNIVERSAL SERVICE FUNDING IS CONSISTENT WITH THE TELECOMMUNICATIONS ACT OF 1996

The Telecommunications Act of 1996 ("1996 Act") provides the Federal Communications Commission ("FCC" or "Commission") with the authority to devise a comprehensive universal service mechanism to distribute funding for access to telecommunications and information services by low-income, rural, insular, and high-cost customers. Under the statutory scheme Congress created in the 1996 Act, the Commission must preserve and advance universal service through certain specific principles. Among these, the Commission must ensure that quality service is available at just, reasonable, and affordable rates and that specific, predictable, and sufficient mechanisms support universal service.¹ Beyond the principles expressly enumerated in the statute, the 1996 Act gives the Commission discretion to abide by any other principles that are necessary and appropriate for the protection of the public interest, convenience, and necessity.²

By giving the Commission the primary responsibility to establish a universal service mechanism, Congress did not intend to eliminate entirely the role of the states. Indeed, the 1996 Act specifically permits states to adopt regulations to preserve universal service as long as they are not inconsistent with the Commission's rules.³ In addition, states may adopt additional definitions and standards to advance universal service policies within their states to the extent that they are specific, predictable, and sufficient mechanisms that do not rely on or burden federal universal service support mechanisms.⁴

The Commission's Staff has sought clarification whether the Commission could adopt a competitive bidding for high-cost support consistent with the precepts of the 1996 Act. These concerns generally fall into two categories, whether auctions would be consistent with: (1) 47 U.S.C. § 214(e), which establishes the criteria carriers must meet in order to become eligible telecommunications carriers; and (2) 47 U.S.C. § 254, which outlines the basic guidelines for Federal and State universal service support mechanisms. GTE's auction proposal would contravene neither of these sections of the 1996 Act.

As demonstrated below, the 1996 Act's mandate affords the Commission sufficient latitude to select a universal service policy that relies on a bidding mechanism to determine universal service support payments. Because GTE's auction proposal is consistent with the 1996 Act's specific provisions, and because it is competitively neutral and efficient, the Commission should adopt GTE's auction proposal.

¹ See 47 U.S.C. § 254(b).

² *Id.* at § 254(b)(7).

³ *Id.* at § 254(f).

⁴ *Id.*

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I. GTE's Auction Proposal Is Consonant With The 1996 Act's Eligibility Criteria For Universal Service Funding

The 1996 Act permits state commissions to designate certain telecommunications carriers as eligible telecommunications carriers.⁵ In addition to defining how carriers can qualify as eligible telecommunications carriers, the statute permits state commissions in areas served by rural telephone companies, and requires state commissions in all other areas, to designate more than one eligible telecommunications carrier.⁶

A. Competitive Bidding Would Not Preclude Competition

Although Section 214(e) contemplates that more than one carrier may be an eligible telecommunications carrier, it does not preclude the adoption of a competitive bidding mechanism. AT&T, for instance, and others have argued in this proceeding that competitive bidding is at odds with the 1996 Act because, as they wrongly conclude, winning bidders must be given exclusive rights to serve an area, which would limit customer choice.⁷

GTE has not proposed an auction mechanism that constrains the number of carriers that can serve as carriers of last resort ("COLRs") in an area, let alone a mechanism that awards an exclusive franchise to auction winners.⁸ Under GTE's auction proposal, multiple carriers could receive universal service support even if they were not the winning bidder in an area. Indeed, all bidders may serve as COLRs and receive universal service support as long as they bid within a specific percentage of the winning bidder.⁹ GTE's proposal would therefore not discourage market entry by carriers willing to serve as COLRs as AT&T fears, but would instead promote market entry because carriers would be assured of universal service support in exchange for their commitment to serve as COLRs.¹⁰

B. Designation As An Eligible Telecommunications Carrier Is A Necessary But Not Sufficient Condition To Receive Universal Service Support

Implicit in AT&T's discussion of competitive bidding appears to be the assumption that once a state commission determines that a carrier is an eligible telecommunications carrier, the eligible telecommunications carrier automatically qualifies for universal service funding. This, however, is contrary to the plain language of

⁵ 1996 Act, § 102 (amending 47 U.S.C. § 214).

⁶ 47 U.S.C. § 214(e)(2).

⁷ Comments of AT&T at 36-37; see also Comments of the Puerto Rico Telephone Company at 16; Comments of U S West, Inc. at 23.

⁸ See, e.g., GTE's Comments In Response To Questions, Attachment 1 at 3 (filed Aug. 2, 1996); GTE's Comments at 10-11 (CC Docket No. 96-45, filed April 12, 1996).

⁹ GTE's Comments in Response To Questions, Attachment 1 at 12-13.

¹⁰ Moreover, GTE's proposal only applies to entry by COLRs for the purposes of receiving universal service support and does not prevent carriers from entering generally.

the 1996 Act. When Congress intended to create an entitlement in the 1996 Act, it used the term “entitled” rather than the term “eligible.”¹¹ Indeed, any other interpretation of the term “eligible” would be contrary to the ordinary usage of the term.¹²

Section 214 expressly provides that an eligible telecommunications carrier may only receive universal service support “in accordance with Section 254.”¹³ The legislative history of Section 214 affirms that “[u]pon designation, a carrier is eligible for any specific support provided under new section 254.”¹⁴ The statute thus makes clear that an eligible telecommunications carrier may only receive universal service support if it qualifies for funding under the support mechanism created pursuant to Section 254.

Section 254 also supports this interpretation of the term “eligible.” For example, Section 254(e) confirms that only eligible telecommunications carriers designated by state commissions shall be eligible to receive Federal universal service support, and defines how “[a] carrier that receives such support shall use that support” and that “any such support should be explicit and sufficient.”¹⁵ If Congress had intended designation as an eligible telecommunications carrier as a sufficient condition to receive universal service support, it could have indicated its intent in the text of the 1996 Act by using the phrase “such carrier” in place of “a carrier that receives such support.” Congress similarly could have indicated how “such support” could be used instead of how “any such support” may be used. Instead, the legislative history of the 1996 Act confirms that “[a]ny eligible telecommunications carrier that receives such support shall only use that support” for specified purposes.¹⁶ This language makes clear that not every eligible telecommunications carrier will necessarily receive support.

As a matter of policy, to permit an eligible telecommunications carrier to qualify for universal service funding automatically upon designation by a state commission would undermine the entire effect of Section 254. Without the parameters that Section 254 gives the FCC and state commissions authority to impose, universal service support would be available to all eligible telecommunications carriers regardless, for example, of which services they offered, what prices they charged consumers, and whether their services met quality standards.¹⁷ If carriers were able to obtain universal service funding

¹¹ Compare 47 U.S.C. § 214(e)(1) (carriers are “eligible” to receive universal service support in accordance with Section 254) with *id.* at § 254(h)(1)(A) (carriers offering service [to health care providers] shall be “entitled” to the difference between rates to health care providers and other customers in comparable rural areas).

¹² For example, Webster’s Encyclopedic Unabridged Dictionary of the English Language defines “eligible” as “1. Fit or proper to be chosen; worthy of choice; desirable; *to marry an eligible bachelor*. 2. Legally qualified to be elected or appointed to office; *eligible for the presidency*...”

¹³ 47 U.S.C. § 214(e)(1).

¹⁴ H.R. Conf. Rep. No. 458, 104th Cong., 2d Sess. 141 (1996) (“Conference Report”).

¹⁵ 47 U.S.C. § 254(e) (emphasis added).

¹⁶ Conference Report at 131.

¹⁷ Section 254 requires the Commission to define the services that will constitute universal service and requires the Commission to ensure that quality services are available at just, reasonable, and affordable rates. See 47 U.S.C. § 254(b)(1), (c)(1).

without regard to the standards established pursuant to Section 254, the FCC and state commissions could not ensure that universal service support would be available on an equitable basis. In addition, if an eligible telecommunications carrier qualified to receive universal service funding immediately, it would encourage a "race to the exit." If all eligible telecommunications carriers could receive universal service funding without adhering to any particular obligations, and all eligible telecommunications carriers knew that if they were the last eligible telecommunications carrier in the market they would face significant obligations, there would be a steady exodus from the marketplace as soon as any eligible telecommunications carrier indicated it was prepared to exit. Because the 1996 Act's intent is to promote competition,¹⁸ the Commission must find that designation as an eligible telecommunications carrier is not sufficient to qualify a carrier to receive universal service funding.

C. State Designation of Geographic Service Areas Does Not Prevent The FCC From Defining Bidding Areas

Because the 1996 Act permits state commissions to define geographic service areas, the Commission's Staff has questioned whether the Commission has the authority to adopt an auction mechanism that might base universal service bidding areas on territories different from state-designated service areas.¹⁹ GTE supports the use of Census Block Groups ("CBGs") or similar small areas for bidding purposes due to their relatively homogeneous cost characteristics.²⁰

Nothing in the 1996 Act prevents state commissions from defining service area obligations based on CBGs. For service areas other than those served by rural telephone companies, states may define service areas in any manner they choose.²¹ In the case of areas served by rural telephone companies, the 1996 Act defines service areas as study areas, but permits the FCC and states, upon recommendation of the Joint Board, to institute a different definition of service areas.²² Thus, if a consensus developed between the states and the FCC that CBGs or similar areas were appropriate for defining the geographic scope of universal service obligations, the 1996 Act would not prevent the states and the FCC from adopting them.

Even if the FCC and state commissions were unable to agree on service area boundaries, however, this would not prevent the FCC from adopting an auction mechanism based on CBGs as bidding areas. While Section 214(e)(5) permits state commissions to define "service areas" in all areas not served by rural telephone companies and in conjunction with the FCC and Joint Board for rural service areas, the 1996 Act does not prohibit the FCC from creating a funding mechanism that uses CBGs

¹⁸ Conference Report at 113.

¹⁹ See also Comments of Century Telephone Enterprises, Inc. and TDS Telecommunications Corporation at 28; Comments of the National Exchange Carrier Association at 31.

²⁰ GTE Comments In Response To Questions at 54.

²¹ 47 U.S.C. § 214(e)(5).

²² Id.

as bidding areas that are distinct from service areas by virtue of its authority under Section 254.

For example, a state commission could designate a carrier as an eligible telecommunications carrier and define its service area as the entire state. This would mean only that the eligible telecommunications carrier would be required to “offer the services supported by Federal universal service support mechanisms” and advertise the availability of such services throughout the state.²³ This would not entitle the eligible telecommunications carrier to receive universal service funding throughout the state because eligible telecommunications carriers may only receive funding “in accordance with Section 254.”²⁴ To receive funding, the eligible telecommunications carrier must in addition comply with the funding mechanism devised pursuant to Section 254, which could provide that universal service support will be based on bidding in areas that are a small subset of each state. To avoid the possibility that states could create service areas that are smaller than the FCC-designed bidding areas, which might raise the possibility that new entrants could “cherry-pick” the lowest-cost areas and harm competition, the FCC could condition the grant of federal funding on whether state commissions adopt service areas that are at least as large as the FCC’s bidding areas.

II. Competitive Bidding Is A Specific, Predictable, and Sufficient Universal Service Support Mechanism Under The Guidelines Of The 1996 Act

Section 254 requires “specific, predictable, and sufficient Federal and State mechanisms to preserve and advance universal service.”²⁵ In addition, Section 254 requires that universal service support be “explicit and sufficient to achieve the purposes of [Section 254].”²⁶ The Commission’s Staff has inquired whether an auction mechanism for determining universal service support would meet the criteria set forth in the statute.

A. Support Payments Under An Auction Plan Will Be Sufficient Because The 1996 Act Prevents Cross-Subsidization

Support payments would only be insufficient under an auction mechanism if bidders had the incentive to proffer unduly low bids in order to squeeze out competitors.²⁷ There is no evidence, however, that this would be the case.²⁸ Section 254(k) specifically forbids the use of revenues from competitive services to cross-subsidize services that are not subject to competition.²⁹

²³ See *id.* at § 214(e)(1).

²⁴ *Id.*

²⁵ *Id.* at § 254(b)(5).

²⁶ *Id.* at § 254(e).

²⁷ Comments of Century Telephone Enterprises, Inc. and TDS Telecommunications Corporation at 27.

²⁸ See Comments of Time Warner Communications Holdings, Inc. at 44; Comments of Bell Atlantic at 14.

²⁹ 47 U.S.C. § 254(k).

Carriers subject to price cap regulation have no ability to cross-subsidize high-cost areas with revenues from competitive services, and other carriers would generally have no incentive to lose money by bidding too low. In the case of new entrants such as cable companies that are not regulated as closely as their competitors, predatory pricing might be harder to detect, but in these instances recourse might be made to the Commission, the state commissions, and the courts.³⁰

B. GTE's Auction Plan Is A Predictable Method To Establish Universal Service Support

With respect to the predictability requirement found in the 1996 Act, ITCs, Inc., for example, argues that competitive bidding is inconsistent with the 1996 Act because no form of auction would result in "predictable support."³¹ ITCs, Inc. misreads the 1996 Act. While the statute requires that the funding mechanism for universal service must be predictable, it does not require that funding levels must necessarily be predictable. Funding levels need only be "explicit and sufficient to achieve the purposes of [Section 254]."³² Even assuming that ITCs, Inc.'s reading of the 1996 Act were correct, basing universal service support on actual costs in rural areas and proxy costs in urban areas, as ITCs, Inc. has proposed, would not necessarily result in more predictable universal service support than auction mechanisms given the controversies that surround cost modeling, changing technology, and population trends.

Under GTE's auction proposal, auctions would in every sense be predictable. Auctions would not occur until they were initiated by a new entrant, and thereafter they would occur at appointed times.³³ After funding levels were set by the competitive bidding process, COLRs would be committed to serve given areas for a specified amount of time, which GTE has proposed should equal three years.³⁴ Auctions would be held again at the end of that period. Competitive bidding under GTE's proposal thus comports with the 1996 Act because it is a predictable mechanism for determining funding for universal service.³⁵

C. Section 254 Requires An FCC-Defined Set Of Minimum COLR Obligations

Consistent with Section 254, any universal service funding mechanism that the Commission establishes must create a set of minimum obligations with which all eligible

³⁰ Comments of the National Cable Television Association at 16.

³¹ Comments of ITCs, Inc. at 21.

³² 47 U.S.C. § 254(e).

³³ GTE has proposed that they occur twice a year. GTE's Comments In Response To Questions at 44.

³⁴ *Id.*, Attachment 2 at 7.

³⁵ GTE's universal service support plan is also specific and sufficient as required by the 1996 Act because it is comprehensive and accounts for universal service support both before and after the emergence of competition and can be applied to all areas in which universal service support is necessary. *See* 47 U.S.C. § 254(b)(5).

telecommunications carriers must comply to receive funding. As demonstrated above, the 1996 Act does not permit eligible telecommunications carriers to receive funding automatically upon designation because once they are eligible telecommunications carriers, they can only obtain funding “in accordance with Section 254.”³⁶ Section 254 gives the Commission authority to develop a funding mechanism that outlines the obligations that eligible telecommunications carriers must incur to qualify for universal service funding.³⁷ These should include:

- Offering a core set of services to all end users in a service area;
- Adherence to state-defined service quality standards and symmetrical terms and conditions of service;
- Interconnection and equal access; and
- Limitations on the ability to exit the market.³⁸

The imposition of a minimum set of symmetrical standards necessary to qualify for universal service funding is not only consistent with the 1996 Act, but is necessary to ensure that funding is competitively neutral. If eligible telecommunications carriers were permitted to receive funding without committing to a minimum COLR obligation established by the FCC, then certain eligible telecommunications carriers might be able to gain a competitive advantage. If the Commission permits eligible telecommunications carriers to offer fewer services, diminished service quality, or higher prices while receiving the same amount of universal service funding, it would fundamentally undermine the pro-competitive objectives of the 1996 Act.³⁹

³⁶ *Id.* at § 214(e)(1). Even prior to state commission eligible telecommunications carrier designations, the FCC must determine what constitutes “universal service” under 254(c) because states must decide whether to grant a carrier’s request to serve as an eligible telecommunications carrier based on whether it offers the services defined under Section 254(c). *See id.* at § 214(e)(1)(A). GTE proposes that the minimum set of core services defined as universal service should include: voice-grade access, touch tone service, single-party lines, access to emergency and operator services, and white pages directory listings.

³⁷ Section 254 not only requires the Commission to provide a universal service mechanism that ensures quality services are available at just, reasonable, and affordable services, but also permits the Commission to apply any other criteria that are appropriate to protect the public interest, convenience, and necessity. *Id.* at 254(b)(7). States should be permitted to refine the minimum COLR obligations set by the FCC.

³⁸ Although the 1996 Act permits eligible telecommunications carriers to relinquish their eligible telecommunications carrier designation, *see id.* at § 214(e)(4), this is distinct from the limitation on the ability of COLRs to exit their markets. As demonstrated above, eligible telecommunications carriers are not automatically qualified to receive universal service funding under the 1996 Act. The Commission should make an exit limitation part of the COLR obligation, which would not be inconsistent with the exit procedures set forth in Section 214(e)(4). At the end of the three-year period proposed by GTE, markets would be open again for bidding. Once a carrier’s COLR obligation expired, the carrier would revert to its eligible telecommunications carrier status. It could then decide whether to relinquish its eligible telecommunications carrier status pursuant to the procedures found in Section 214(e)(4). *See id.* at § 214(e)(4).

³⁹ Conference Report at 113.